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Recent developments in the debt situation of developing countries

Report of the Secretary-General*

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* This report was submitted on 26 September 2000 so that the updated information required for a commentary on the latest developments could be included in this comprehensive and substantive analysis of the external debt and debt-servicing problems of the developing countries.

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I. Introduction

1. In its resolution 54/202 of 22 December 1999, the General Assembly, reaffirming the urgent need for further implementation of existing mechanisms for the treatment of the external debt and debt-servicing problems of developing countries in order to help them exit from the rescheduling process and unsustainable debt burdens, addressed the possibilities of enhancing international cooperation regarding a durable solution to these problems. The Assembly requested the Secretary-General to report to its fifty-fifth session on the implementation of that resolution and to include in his report a comprehensive and substantive analysis of the external debt and debt-servicing problems of the developing countries. The present report has been prepared in response to that request.

2. An analysis of key debt indicators[1] shows that external debt and debt-servicing problems are most severe and persistent in the heavily indebted poor countries (HIPCs), the target group of the HIPC Initiative. However, a number of other developing countries and countries in transition are also in a vulnerable position. Although growth in these countries started to recover after the 1997-1998 global financial crisis, debt restructuring problems linger and countries remain exposed to adverse developments in commodity prices, interest rates, exchange rates and private capital flows. A few of them have found it necessary to reschedule their external obligations. Moreover, the debt-servicing capacity of some countries continues to be affected by war and natural disasters.

3. Various strategies have been adopted to tackle the debt problems of these countries. In this respect, the attention of the international community has over the recent past largely focused on the HIPC Initiative; but progress has been much slower than expected and the initiative is suffering from problems of underfunding, excessive conditionality, restrictions over eligibility, inadequate debt relief and cumbersome procedures. Steps have been taken to speed up the HIPC process and there is now a commitment to doubling the number of countries for which debt reduction is agreed from 10 in September 2000 to 20 by December 2000. While such an acceleration is welcome, the current approach is not likely to succeed in removing the debt overhang of the world's poorest countries. For this purpose (as discussed further in sect. III) one approach, while the existing processes are under way, would be to establish an independent panel of experts that would assess or reassess debt sustainability, eligibility for debt reduction, the amount of debt reduction needed, conditionality and financing (including the provision of necessary funds for the multilateral financial institutions affected) for all HIPC countries including those that have already benefited and those that are set to benefit from debt reduction in the coming months under the existing initiative. The latter two groups should benefit from additional debt relief if the panel determines that the debt reduction provided under the HIPC Initiative is inadequate. The design of the modalities for such an approach could be expected to draw on experience of domestic insolvency procedures in major industrialized countries as well as that of insolvency procedures in private international law. The approach should not be limited to HIPCs but should incorporate a broader spectrum of countries in need of special measures to overcome their official debt problems. Simultaneously there should be agreement on the suspension of debt-service payments by all HIPCs, with no additional consequent interest obligations being incurred, until the panel had made its recommendations and agreement had been reached on the reduction of their debts. This suspension could also be extended to non-HIPC countries declared eligible for relief by the panel during the period required for eventual agreement on debt reduction in their case.

4. Similarly, despite the proliferation of meetings and multiplications of groups and forums discussing the reform of the international financial architecture since the outbreak of the recent bouts of financial crises in emerging markets, the international community has not been able to address the concerns of developing countries concerning the contents of such reform, particularly with respect to orderly and equitable work-outs for commercial debt and provision of adequate international liquidity under appropriate terms and conditions to countries facing serious debt-servicing difficulties. Rapid progress needs to be made in these areas in order to ensure that closer integration of developing countries and economies in transition into the global financial system does not undermine their stability, growth and development.

5. This report takes up these issues. It will first give a brief review of the progress made in HIPC Initiative implementation and make an assessment of its shortcomings. The report will then turn to non-HIPC debtors, discussing their problems with respect to both

official and commercial debt. This is followed by a discussion of debt problems in emerging markets that have experienced serious financial difficulties in recent years, and of outstanding issues in commercial debt work-outs. The report will end with some proposals for reform of the international approach towards the debt problems of developing countries and economies in transition.

II. International debt problems and strategies

6. Total outstanding debt of developing countries and countries in transition showed little change in 1999. The total debt of these countries at the end of 1999 is estimated at $2,554 billion after a small increase over the end-1998 level (see table). Long-term debt increased by $40 billion, while short-term debt fell slightly and represented 16 per cent of total debt at end-1999. The debt service ratio remained broadly unchanged in 1999 at about 18-19 per cent. The ratio of total outstanding debt to exports fell to 137 per cent; and that of debt to gross national product (GNP) decreased slightly to below 42 per cent. Short-term debt corresponded to 53 per cent of the stock of foreign exchange reserves as compared with 59 per cent at the end of 1998 and with over 70 per cent at end-1997.

7. The distribution of debt among different regions remained the same in 1999 as in 1998. East and South Asia accounted for 33 per cent of the total, Latin America for 31 per cent, and Europe and Central Asia for 19 per cent, while sub-Saharan Africa's share was 9 per cent and that of the Middle East and North Africa 8 per cent. Latin America has the highest ratio of debt service to exports, about 35 per cent, while the highest debt-to-exports ratio, 225 per cent, is recorded by sub-Saharan Africa.

8. Despite the slowdown of growth of the external indebtedness of the developing countries and countries in transition, debt and debt-servicing problems persist in a number of these countries. The problems of the HIPCs, which are structurally rooted, are far from being resolved, while other poor countries have also been affected by the recent financial and economic crises in emerging markets and some of them have encountered payments problems as a result. Many of the emerging markets that have experienced financial instability and crisis in recent years are suffering from domestic as well as external debt difficulties that threaten the sustainability of their recovery.

A. The Heavily Indebted Poor Countries (HIPC) Initiative

1. Progress in design and implementation and other recent policy developments

9. The HIPCs in general are characterized by extreme poverty, poor social development indicators and human resources, poorly diversified economies, a high concentration of export earnings in a few primary commodities, and dependence on official aid as well as high debt overhang. The last-mentioned is reflected in high levels of debt in relation to national income, high ratios of debt service to exports, large payments arrears, and high ratios of debt service to government revenue. By the end of 1999, little assistance had been delivered under the HIPC Initiative, with only a negligible impact on the aggregate debt stocks and indicators of the HIPCs. According to recent available estimates,[2] the HIPCs' total outstanding external debt increased by some $4.5 billion in 1999 to a level of $219 billion, and in this year the ratio of debt to exports amounted to 389 per cent, more than twice that for developing countries as a whole and considerably above that of sub-Saharan Africa (including the region's HIPCs). There are currently 41 countries on the list of HIPCs.[3] Thirty-three of them are in sub-Saharan Africa, and 30 are classified as least developed countries.

10. Following the Cologne Summit in June 1999, a number of specific modifications to the HIPC Initiative aiming to provide "deeper, broader and faster" debt relief were endorsed at the International Monetary Fund (IMF) and World Bank Annual Meetings in September 1999.[4] Deeper and broader relief is expected to be achieved through a lowering of debt sustainability targets,[5] resulting in an increase in the number of countries to become eligible for HIPC assistance. The new scheme retains the basic framework of a two-stage process requiring an established track record of policy implementation before the delivery of relief. As before, the "decision point" — when a country's eligibility for HIPC relief is assessed — is normally reached after three years of satisfactory performance under IMF- and World Bank-supported adjustment programmes. Another feature of the new scheme is the provision of additional interim assistance for eligible countries,

External debt of developing countries and countries in transition

(Billions of United States dollars)

	All developing countries		*Sub-Saharan Africa*		*Middle East and North Africa*		*Latin America and the Caribbean*		*East Asia and the Pacific*		*South Asia*		*Europe and Central Asia*	
	1998	*1999*	*1998*	*1999*	*1998*	*1999*	*1998*	*1999*	*1998*	*1999*	*1998*	*1999*	*1998*	*1999*
Total debt stocks	2 536.0	2 554.0	230.1	231.1	208.1	214.2	786.0	792.7	667.5	659.4	163.8	170.7	480.5	485.9
Long-term debt	2 030.3	2 070.7	180.3	179.1	164.1	169.4	640.5	649.0	517.1	530.6	154.2	159.9	374.2	382.8
Public and publicly guaranteed	1 529.2	1 580.1	171.1	169.4	159.6	161.4	424.2	440.6	337.7	365.0	143.1	147.2	293.5	296.6
Private non-guaranteed	501.1	490.6	9.1	9.7	4.5	8.0	216.3	208.4	179.4	165.6	11.1	12.7	80.8	86.2
Short-term debt	411.9	402.3	42.5	44.7	41.0	41.8	123.5	122.6	119.1	106.1	7.2	8.5	78.6	78.6
Arrears	128.0	..	63.2	..	12.1	..	11.9	..	17.1	..	0.8	..	22.9	..
Interest arrears	36.2	40.7	20.2	20.4	2.4	2.4	3.6	3.6	2.0	2.0	0.3	0.3	7.7	12.0
Principal arrears	91.8	..	43.0	..	9.7	..	8.3	..	15.1	..	0.5	..	15.3	..
Debt service paid	316.1	349.4	14.1	15.2	22.6	21.1	125.3	140.6	84.8	103.5	16.4	15.2	52.9	53.7
Debt indicators (percentage)														
Debt service/ Exports of goods and services	18.5	18.7	14.7	14.8	14.3	11.0	33.6	34.5	13.3	14.8	18.9	14.5	14.7	14.8
Total debt/ Exports of goods and services	148.0	136.6	238.7	225.1	131.2	111.3	210.5	194.6	104.9	94.4	189.2	162.5	133.7	133.7
Total debt/ GNP	42.2	41.5	72.2	75.8	35.8	44.2	40.9	46.2	40.2	34.8	29.1	28.2	49.0	42.2
Short-term/ reserves	58.9	53.1	139.9	135.5	62.4	60.1	74.7	74.7	40.0	30.9	19.2	21.3	76.3	72.8

Source: World Bank, *Global Development Finance 2000* (Washington, D.C., 2000).
Note: Two dots (..) mean data unavailable.

including relief from IMF and the World Bank as well as more concessional restructuring of debts provided within the Paris Club framework under Cologne terms (90 per cent or higher debt reduction in present value terms as compared with 80 per cent under previously applied Lyon terms). The second stage of the process leads to the "completion point" and full delivery of HIPC assistance from participating creditors. While under the initial framework another three-year period of satisfactory policy implementation was in principle required, there is now the possibility of shortening the second stage of the HIPC process if the debtor country meets ambitious policy targets early on. Introduction of this "floating completion point" allows Governments to set their own pace of implementation of reforms.

11. A main innovation under the enhanced HIPC framework is the explicit link to poverty reduction. HIPCs are now required to present Poverty Reduction Strategy Papers (PRSPs) as part of the debt-relief process. A country aspiring to assistance under the initiative would normally be expected to have in place a comprehensive and participatory poverty reduction strategy before the decision point. In practice, interim strategies have served as a basis for the decision points for most countries now being processed under the new framework. Finalization of the PRSPs and satisfactory initial progress in implementation are expected from countries before delivery of relief at the completion point; early experience indicates that reaching this point may take one or two years. This link to poverty alleviation and the need to reach agreement on PRSPs through processes involving participation of the civil society render the HIPC process even more complex than before.

12. Up to the end of July 2000, nine countries had reached their decision points under the enhanced scheme. Bolivia, Mauritania and Uganda were declared eligible for additional relief in February 2000, Mozambique and the United Republic of Tanzania followed in April 2000, Senegal in June 2000 and Benin, Burkina Faso and Honduras in July 2000.[6] In all, these nine countries are estimated to receive more than $15 billion in nominal terms in additional debt relief, representing an average reduction in the present value (PV) of debt stocks of close to 45 per cent on top of traditional relief mechanisms. The objective is to have 20 HIPCs reach their respective decision points under the new framework by the end of 2000.[7]

13. Uganda became the first HIPC country to achieve the completion point under the enhanced HIPC Initiative in early May 2000. Bolivia was expected to reach this point during the second half of 2000, to be followed by Benin, Burkina Faso, Mozambique, Senegal and the United Republic of Tanzania in 2001, and Honduras and Mauritania in 2002. In these first cases under the enhanced framework (six reassessments taking into account the revised debt sustainability targets and three new cases), the countries have to a large extent been able to draw on pre-existing national poverty action plans and strategies for the preparation of the PRSPs that are to be presented to the Bretton Woods institutions.

14. There was no new Paris Club agreement concluded during the period from August 1999 through February 2000, while the modalities for implementing the enhanced HIPC framework were being put in place. In March 2000, Mauritania became the first country to benefit from Cologne terms under a Paris Club agreement, followed by the United Republic of Tanzania in April 2000. Both these countries obtained flow reschedulings, with notably all creditors providing debt reduction, that is to say, outright cancellation of payments due during the consolidation period. In addition, Sao Tome and Principe in May 2000 negotiated its first-ever Paris Club agreement, a flow rescheduling on Naples terms in support of the country's new Poverty Reduction and Growth Facility (PRGF) arrangement with IMF. In order to assist Mozambique in dealing with the emergency situation created by devastating floods, the Paris Club in March 2000 decided to defer all payments due until the country will have reached its completion point (scheduled for mid-2001) and arrangements for debt cancellation at that time will have been made. Similar arrangements for a one-year deferral of debt service due by Mozambique have been made by IMF and the World Bank.

15. An important development in late 1999 and early 2000 has been the commitment by an increasing number of creditor countries to granting even deeper debt relief than under the Cologne terms. In this regard, a breakthrough made towards full cancellation of (bilateral) claims was the pledge by the President of the United States of America in September 1999, in connection with the IMF and World Bank Annual Meetings, to forgive 100 per cent of debts within the context of the HIPC Initiative. Other creditor countries,

notably all Group of Seven (G-7) countries, have followed with similar declarations. In April 2000, G-7 finance ministers and central bank governors meeting in Washington, D.C., collectively committed themselves to increasing debt reduction to 100 per cent of non-official development assistance (ODA) claims treated within the Paris Club framework,[8] a commitment reaffirmed by G-7 leaders at the Okinawa Summit of July 2000.[9]

16. However, the above should not be interpreted to mean that HIPCs can henceforth expect rapid or across-the-board cancellation of their bilateral debts: cancellation would in principle be limited to countries going through the initiative, and would be dependent on their progress in economic policy reform and poverty reduction. Country coverage, the timing of relief and the coverage of debts, for example, post-cut-off date debt, may also vary from creditor to creditor. Relief also depends on legislative authorization for the release of funds.

17. HIPC-related debt issues continued to feature high in the international agenda in the wake of the Okinawa Summit. The Italian Parliament in July 2000 enacted a bill enabling the full cancellation of debts (development and commercial) owed to Italy and significantly expanding the number of potential beneficiaries beyond the HIPC category.

18. The G-8 meeting in Okinawa, however, did not advance any major new initiative on debt similar to the Cologne debt initiative a year earlier. The leaders agreed to push forward the HIPC Initiative and work together to ensure that as many countries as possible reached their decision points, in line with the targets set in Cologne. They voiced concern about the number of HIPCs currently affected by military conflicts preventing poverty reduction and delaying debt relief, and agreed to strengthen efforts to help them prepare for and come forward for such relief. They also promised to promote more responsible lending and borrowing practices to ensure that HIPCs would not again be burdened by unsupportable debt.[10] A number of other issues were also raised at the summit including the essential role of ODA in the fight against poverty and the need for an improved trade and investment environment and for faster integration of the developing countries, including the poorest, into the global economy.[11]

2. Outstanding issues

19. As of July 2000, only a small number of countries were well advanced in the HIPC process, while others have as yet to meet the requirements for entering the process; that is to say, they have not embarked on IMF- and World Bank-supported programmes and have not entered into Paris Club negotiations for concessional rescheduling. The countries concerned are almost all least developed countries suffering from civil conflict or severe governance problems, and are among the most indebted HIPCs. The Boards of IMF and the World Bank have supported extending the HIPC "sunset clause" by another two years to give countries an incentive to adopt the required programmes by the end of 2002.

20. Overall progress is affected by the laborious resource mobilization for the initiative, which is funded essentially through voluntary contributions. Agreement on the use of IMF gold holdings to help finance the Fund's participation was reached at the Annual Meetings of the Bretton Woods institutions in September 1999. Subsequently, a series of off-market transactions were conducted and completed by early April 2000, raising about $3 billion which has been invested to generate income for the initiative. Pledges of substantial new bilateral contributions to IMF and World Bank HIPC trust funds have also been made.[12] Yet full financing of the initiative is not yet assured.

21. Resources are required to meet not only the full debt-relief costs of IMF and the World Bank/International Development Association (IDA) over the expected duration of the HIPC scheme, but also those of other multilateral institutions holding claims on HIPCs, some of which are encountering difficulties in contributing their share of HIPC relief. Concerns have been expressed by some regional development banks and other financial institutions about the impact of the HIPC Initiative on their financial integrity and long-term sustainability, and on the borrowing costs for non-HIPC developing member countries. Agreements concerning the participation in the HIPC Initiative of the Inter-American Development Bank (IDB) and other regional institutions in Latin America and the Caribbean, and of the African Development Bank were reached only a few months ago.

22. If funding uncertainties remain, there is first the risk of delay in individual cases. For instance, the

finalization of the new debt-relief package for Bolivia was dependent on the participation of IDB, the country's largest creditor, as well as other regional financial institutions. Similarly, donor pledges that remained to be secured under the IDB financing framework agreed in June 2000 have held up the release of IMF interim assistance to Honduras.

23. More generally, if resource shortfalls persist, if seeking assurance on the participation of all creditors before the finalization of debt-relief packages continues to be a lengthy and difficult process, and if country cases in consequence cannot be brought forward to the decision point, then the initiative risks slowing down to a halt. A shortfall in resources could emerge as soon as late 2000, IMF's continued participation, for example, not being assured beyond this date.[13]

24. The link between poverty alleviation and debt relief under the enhanced HIPC framework raises some fundamental questions. The original objective of the HIPC Initiative was to provide a clear exit from unsustainable debt burdens, while under the enhanced framework poverty reduction has been added as another major objective. However, it remains an open question whether the mechanisms foreseen under the new framework can fulfil both these aspirations. There can be little doubt that HIPC assistance can have an important role to play in improving social spending. However, there is a danger that the current approach concentrates too much on public social spending programmes, diverting attention from the fundamental task of raising the level and productivity of investment needed to achieve the economic growth that is a prerequisite of sustained reductions in poverty.[14]

25. Some light can be shed on the latter issue by recent estimates of the United Nations Conference on Trade and Development (UNCTAD) secretariat for the external financing requirements of sub-Saharan Africa. According to these estimates, there is a need to double the existing level of official financing in order to sustain a growth rate of 6 per cent. This would mean raising the net official capital inflows by about 7 per cent of the combined gross domestic product (GDP) of the countries in the region. On the other hand, principal repayments and interest payments on official debt by these countries amounted to just under 3 per cent of their combined GDP in the past five years. This means that if countries in sub-Saharan Africa were all to be brought under the HIPC framework and granted full and immediate relief on their official debt, the amount thus released would be less than half of the external financing requirement for achieving the rate of growth needed.[15] Certainly, for HIPC countries alone, in sub-Saharan Africa and elsewhere, the external financing requirements in relation to GDP could be expected to be greater since many of them have lower domestic savings rates and private capital inflows. On the other hand, the average ratio of principal repayments and interest payments on official debt by HIPC countries over the past five years is similar to that of the countries of sub-Saharan Africa, just under 3 per cent of their combined GDP. It can thus be estimated that full and immediate debt relief to HIPC countries on their entire official debt would release resources amounting to no more than approximately one third of their additional resource requirements for achieving the growth needed to make a dent in poverty. Thus, the international community could not rely on the HIPC Initiative alone for poverty alleviation even if the initiative were to be fully and rapidly implemented.

26. This also points to the importance of additionality in the provision of resources for debt relief over and above development aid. If participating countries and institutions do not ensure genuine additionality of their contributions, debt reduction will not close the resource gap and hence improve the prospects for sustained poverty reduction. This is a serious risk in view of indications that some donors are already diverting regular aid resources to their contribution to the HIPC Initiative.

27. It cannot yet be judged precisely from the early cases whether HIPC assistance will actually succeed in lowering debt burdens to agreed targets or in maintaining debt at sustainable levels. Achievement of debt sustainability is a function not only of the amount of debt relief delivered, but also of the growth of export earnings and government revenue. A standard assumption in Enhanced Structural Adjustment Facility (ESAF)/PRGF projections, reflected in the debt sustainability analysis (DSA) papers prepared for the HIPC Initiative, is of steady robust export growth. However, the experience of the first set of HIPC countries shows that this is not always realistic. For instance, export growth in the order of 6 to 7 per cent was originally projected for Uganda for 1999/00, but recent figures indicate that exports actually fell, by around one fifth, during this period. In the case of Guyana, which reached its first completion point in

1999, qualifying under the fiscal criterion, the ratio of the present value of debt to government revenue was estimated at 410 per cent as compared with a target ratio of no more than 280 per cent. If HIPCs are to maintain debt sustainability over time, then, in estimating the amount of debt relief needed, it is important to formulate realistic projections for export earnings and government revenues, and to allow for fluctuations associated with the vulnerability of these economies to external shocks.

28. While the enhanced HIPC/PRSP initiative recognizes the importance of "ownership" by debtor Governments for its success, its design is not consistent with this objective. The poverty reduction objective has been added by creditors and donors without appropriate consultations with the debtors concerned. They also largely set the PRSP policy agenda and prescribe the modalities to be followed, leaving little autonomy to debtor countries. Creditors set the terms and conditions for debt relief, which tend to depend as much on their willingness to provide resources as on the needs of the debtor countries. The ultimate judgement on whether and when poor countries qualify for such relief is in the hands of the Bretton Woods institutions. The enhanced HIPC scheme adds a further layer of conditionality, which risks overwhelming the capacities of the debtor country administrations concerned and may effectively dilute "ownership" and autonomous policy-making. The rationale for proliferation of conditionality and cross-conditionality is highly questionable in view of mounting evidence, partly coming from the Bretton Woods institutions themselves, that this instrument is not effective in improving programme performance.[16]

29. Overall, HIPC is a cumbersome and costly process requiring extensive preparations from the debtors concerned. A lengthy consultation process is involved and a large number of documents have to be elaborated and submitted for consideration by various bodies at the successive stages of the process. Moreover, as HIPCs move forward within the process, they experience a drawn-out negotiation process that requires significant technical capacity: there are a series of Paris Club agreements to be negotiated and these are followed by bilateral agreements with individual creditors. All of this places great demands on HIPCs' scarce and already strained manpower resources.[17]

B. Non-HIPC debtors

30. There are 18 least developed countries that are not included in the HIPC category, and some of them are considered severely or moderately indebted according to the World Bank classification.[18] A number of special measures have been devised for the least developed countries such as the reliance mainly on grants in the provision of financing to them. Most least developed countries are IDA-only countries and thus in principle have access to special relief measures such as concessional rescheduling in the Paris Club and the IDA Debt Reduction Facility (DRF). Most donor countries have also extended ODA debt cancellation to the least developed countries. However, the least developed countries' external debt burden has continued to grow over time. The G-8 summit in Birmingham in May 1998 called on those countries that had not already done so to forgive least developed countries' aid-related debts or take comparable action for least developed countries undertaking economic reform.

31. Most of the debt-distressed African countries are either among the group of HIPCs or among the group of least developed countries. However, there are notable exceptions such as Algeria and Morocco in North Africa (which are classified as moderately indebted middle-income countries); Gabon and Nigeria (both severely indebted); and Zimbabwe (a moderately indebted low-income country). A discussion of African debt problems thus cannot be confined to the HIPC Initiative or special measures adopted in favour of least developed countries alone.

32. Debt-relief options for low-income countries included in neither the HIPC nor the least developed country category are restricted. Apart from Nigeria and Zimbabwe, there are six low-income countries classified as either severely or moderately indebted that belong to neither the HIPC nor the least developed country category. Moreover, there are, altogether, nine severely indebted middle-income countries some of which have similar external debt problems. Several of these countries (for example, Indonesia, Ecuador, Jordan and Pakistan) are continuing or have re-entered the process of debt rescheduling with Paris Club creditors over the past two years. Indonesia negotiated a new agreement with its official creditors in April 2000, and Ecuador entered into new talks with the Paris Club in May 2000. Pakistan's current agreement

with the Paris Club expires at the end of 2000. Nigeria, with a huge debt burden, is also expected to return to the Paris Club in the context of a programme of economic revival that received some IMF support in August 2000.

33. Some of the severely indebted low- and middle-income countries have in the past been able to obtain reduction of their liabilities to commercial banks under the Brady Plan. However, similar mechanisms do not exist for their official debts. HIPCs apart, among the countries that have over the recent past rescheduled their debts with the Paris Club, it is only the Russian Federation for which, in the 1996 and 1999 Paris Club agreements, stock treatment and comprehensive solutions to debt problems have been foreseen. Some of the debt-distressed low-income countries are "blend countries" eligible for a blend of International Bank for Reconstruction and Development (IBRD) and IDA funds, as opposed to other low-income countries that are IDA-only and have limited access to private financing. In practice blend country status has so far excluded such debtor countries from schemes providing a writing-down of obligations such as concessional reschedulings from the Paris Club, or other concessional debt-relief facilities reserved for IDA-only countries, such as those covered by the HIPC Initiative and the DRF. For such countries, official debt-relief options have to be seriously considered, including reductions at least on Toronto terms or even the extending of HIPC Initiative benefits. The same also applies in principle to severely indebted IBRD-only middle-income countries. Paris Club agreements do as a rule provide for debt conversion,[19] but experience of such programmes has been mixed: they are in general too complex to implement effectively and they have budgetary implications for the debtor countries concerned.[20]

34. Special debt-relief measures are also needed to help countries affected by war and natural disasters. Deferrals of payments recently granted in the cases of seriously affected countries following hurricane Mitch in late 1998 and the floods in Mozambique in early 2000, as well as in the context of the Kosovo crisis in 1999, provide examples of a mechanism that could perhaps be employed in other cases as well.

C. Recent conditions in markets for commercial debt

35. While HIPCs and least developed countries draw mainly on official sources for external financing, larger low-income countries as well as most middle-income countries have some access to private capital markets. In particular, bond issuance in international financial markets has come to play an increasingly important role in recent years as a source of debt financing. While in 1980 international bonds accounted for less than 5 per cent of total long-term commercial debt of developing countries, this ratio reached 40 per cent at the end of the 1990s. Bond financing is gaining importance particularly as a source of external private financing for sovereign borrowers. Taking a sample that includes five major borrowers in Latin America, plus five major borrowers in Asia,[21] which jointly account for 42 per cent of total developing-country debt, between 1995 and 1998 debt stocks in the form of bond issues increased by 38 per cent, while the total public and publicly guaranteed debt of these countries increased by only 14 per cent. Private sector bond issues have also been rising rapidly in recent years, now accounting for over 20 per cent of the total long-term private debt.

36. Following the financial crisis in East Asia, both the magnitude and terms of debt financing have undergone substantial changes. After falling sharply in 1998, the decline in net private capital inflows to developing and transition economies in the form of debt continued in 1999. The exposure of Bank for International Settlements (BIS)-reporting banks to such economies fell by 7 per cent in both 1998 and 1999. In 1999, more than 50 per cent of the total decline was due to the change in exposure to East Asia. The severe contraction in 1998 reflected the widespread withdrawal of lending facilities to countries in the region in the aftermath of its financial crisis, including for a while those linked to the financing of trade flows, while the 1999 contraction was influenced by a reduced need for borrowing due to the accumulation of foreign exchange reserves resulting from trade surpluses.

37. Net issues of international debt instruments (money-market instruments and bonds) by developing and transition economies rose slightly in 1999. Once again, issues were heavily concentrated among Latin American borrowers, and among Governments and State agencies. Much of new bond issuance in 1999

took place in the second quarter: this bunching reflected partly the bringing to the markets of bonds whose issuance had been postponed during the turbulence in international financial markets at the time of the Brazilian crisis. During the remainder of 1999, net issues continued at lower levels but issuance accelerated in the first quarter of 2000. Gross issues by Latin American borrowers continued at higher levels than net issues owing to substantial refinancing throughout the year. Elsewhere, net issuance was low. New announced bond issues in the first quarter of 2000 reached the level of $25 billion, more than 40 per cent of that for 1999 as a whole. However, such buoyancy will be difficult to sustain as rates of interest increase for major currencies.

38. The yield spreads in secondary markets on the bonds of emerging-market borrowers began the year at levels still reflecting the aftermath of the turbulence that had followed the summer of 1998. For most of these economies, the rest of the year was marked by a fall in such spreads, but this movement tended to peter out in the first quarter of 2000. While interest paid on new debt has stabilized following the sharp increases experienced after 1997, recent hikes in interest rates in the major industrialized countries have pushed up the cost of issuing new debt and have offset, at least in part, the declines in spreads over the past year.

D. Recent debt restructuring agreements

39. In the second half of 1999 and first half of 2000, Pakistan and Ukraine completed new bond restructuring arrangements. In November 1999, Pakistan offered to exchange outstanding eurobonds for a new six-year instrument with a three-year grace period; the offer was accepted by a majority of the bond holders. Ukraine in July 1999 reached an agreement to restructure a $163 million eurobond, repaying 20 per cent of the bond in cash and swapping the remaining part into a new three-year bond. Again, in February 2000, Ukraine announced an offer to exchange a portion of its outstanding debt falling due in 2000-2001 for new bonds with a maturity of seven years. The offer was accepted by more than 95 per cent of the holders of the outstanding value of debt.

40. The Russian Federation initiated negotiations with its London Club creditors shortly after the onset of the financial crisis, with the objective of a general restructuring, including debt forgiveness, of debt of the former Union of Soviet Socialist Republics. The negotiations lasted 18 months mainly because the two sides found it hard to agree on the size of debt forgiveness. Eventually, in February 2000, creditor banks agreed to write off 36.5 per cent of the face value of a total of $31.8 billion ex-Soviet debt, equivalent to $10.6 billion, compared with 40 per cent forgiveness requested by the Russian Federation. The rest of the ex-Soviet debt will be restructured into 10-year and 30-year eurobonds with a 7-year grace period. The terms of the eurobond swap are close to the 35 per cent discount that was standard in the Brady deals in the 1980s and 1990s. Over the years, commercial bank creditors had, already, in fact, by and large put aside sufficient reserves to write off their positions. Moreover, as an outcome of the negotiations, they have gained the security of holding claims against the Russian Federation. From the perspective of the Russian Government, the deal eased the pressure on the federal budget, and is expected to facilitate the country's return to the international capital markets in 2001.

41. Following the approval in February 2000 of an extended agreement with IMF in support of the country's economic and financial programme, Indonesia in April 2000 concluded a new agreement with its official creditors to reschedule principal repayments falling due over the period up to the end of March 2002. It obtained slightly more favourable terms (a slightly longer consolidation period, longer maturity for non-concessional debts, a longer grace period for ODA debts) than in the previous agreement of September 1998. Non-concessional debt was rescheduled over 15 years, including 3 years of grace, at market interest rates and with a graduated repayment schedule. ODA debts were rescheduled over 20 years including 7 years of grace. The agreement also contains a clause providing for debt conversion of up to 10 per cent of concerned outstanding credits.

42. An important change in the stock of developing-country debt available for trading in the secondary market is the considerable decline in the share of the Brady bonds. The trend of retiring outstanding Brady bonds through buy-back and exchange operations[22] had started in 1996, and after a slowdown during the Asian crisis, it picked up momentum in 1999. Five middle-income countries (Argentina, Brazil, Mexico, the Philippines and Uruguay) retired $6.8 billion of Brady bonds through discounted exchanges and open-market

debt buy-backs.[23] Bond exchanges began with relatively small amounts, but more recently some major transactions took place. In June 2000, Argentina exchanged $3.3 billion worth of Brady bonds for $2.4 billion in 15-year eurobonds. Following an earlier modest exchange, in August Brazil successfully completed an exchange of $5.22 billion of Brady bonds for $5.16 billion of 40-year callable, unsecured global bonds. This is the largest-ever emerging-market bond exchange, and at one of the longest maturities achieved by an emerging-market sovereign. The transaction freed $311 million in United States Treasury bonds as collateral and resulted in substantial savings in the present value of interest and repayments.

43. From mid-1999, Ecuador started having serious difficulties in making interest payments on its Brady bonds. As rolling over maturities would not have provided a solution, the country sought a large amount of debt reduction by offering an exchange for global bonds issued at market rates, but with a 20-year maturity period, which was rejected by the bond holders. After a number of failed attempts, bond holders accepted in mid-August Ecuador's offer to exchange $6.65 billion in defaulted Brady bonds for 30-year global bonds at a 40 per cent reduction in principal.

E. Financial crises and debt in emerging markets

1. East Asia

44. The crisis in East Asia has resulted in significant changes in the debt profile of the countries most affected, namely, Indonesia, the Republic of Korea, Malaysia, the Philippines and Thailand. This is true not so much for their overall external indebtedness as for the maturity structure of their debt and its distribution between private and public sectors. More fundamentally, external debt-servicing difficulties and currency turmoil led to sharp increases in defaults and non-performing loans (NPLs) in the private sector, including both financial and non-financial firms. As in almost every major financial crisis in emerging markets and elsewhere, management and resolution of the crisis in East Asia have necessitated massive intervention by the public sector with attendant consequences for public indebtedness and fiscal balances.

45. Commercial loans have traditionally been the main source of external debt-financing in the region, although Indonesia has a relatively important amount of official concessional finance. A large proportion of external debt of the East Asian countries was owed by private financial and non-financial firms rather than by the public sector. Many of these firms were driven into serious financial difficulties and bankruptcy by the collapse of the currencies and hikes in interest rates, even though initially most of them had been solvent. However, despite the sharp increases in bankruptcy of private debtors, the overall external indebtedness of the countries concerned has barely changed over the past two years. For instance, the recorded total external debt stock of these countries fell by a little over 1 per cent in 1999 compared with the previous year, and the decline was due to repayment of existing debt rather than writing-off of the unpayable debt of bankrupt private firms. This anomaly reflects the absence of effective, speedy and equitable debt work-out mechanisms for dealing with international claims and obligations among private agents.

46. However, there has been considerable variation among the individual countries regarding changes in their external indebtedness, reflecting disparate movements in their incomes as well as differences in the extent of debt repayment after the outbreak of the crisis. Thus, the Republic of Korea's classification has been raised by the World Bank from a "moderately indebted" to a "less indebted" middle-income country, while Indonesia has been downgraded to the status of a "severely indebted" low-income country. The other three countries most affected by the crisis (Malaysia, the Philippines and Thailand) have remained as moderately indebted middle-income countries.

47. The structure of the East Asian external debt has shown some improvement owing to a widespread lengthening of maturities: for the majority of countries with large borrowings from banks, the proportion of their exposure with a residual maturity of at least one year was about 60 per cent at the end of 1997 but by early 2000 this figure had fallen to 50 per cent or lower for countries other than Republic of Korea and Taiwan Province of China.[24] International reserves have also been rebuilt, thus enhancing the ability to service debt and absorb external shocks. Reductions in short-term indebtedness as well as the build-up of reserves have been achieved at the expense of massive cuts in

imports, deep recession and mounting social costs associated with loss of jobs and incomes.[25]

48. Gross public debt (domestic and external) increased almost fourfold in Indonesia, the Republic of Korea and Thailand over the period 1996-1999 whereas the increase was more moderate in Malaysia (some 44 per cent).[26] These figures include public borrowing from multilateral financial institutions and creditor countries as part of international rescue packages put together in response to debt-servicing difficulties. They do not include contingency claims that resulted from debt restructuring operations when Governments were obliged to provide guarantees for non-guaranteed private external debt, as, for instance, was the case for the Republic of Korea in respect of its restructuring package of January 1998. The fact that the overall stock of external debt of the crisis-stricken countries remains unchanged, means that a greater proportion of such debt is now accounted for by the public sector, even excluding contingent claims. This is consistent with the changes in the overall pattern of private debt flows to emerging markets after the East Asian crisis when non-guaranteed borrowing almost disappeared while public and publicly guaranteed debt shot up, largely as a result of the socialization of private debt.[27]

49. The increase in public domestic debt was particularly sharp in Indonesia; there had been virtually no domestic public debt in that country in 1996, but it rose sharply after the crisis, reaching $53 billion in 1999. The increase was also sizeable in the Republic of Korea and Thailand where the stock of public debt had risen from some $7 billion in 1996 to $15 and $24 billion respectively in 1999.[28] These increases resulted from domestic rescue packages as well as mounting fiscal deficits that had emerged with the onset of recession and the hike in interest rates.[29] A comparison with the debt crisis of the 1980s shows that not only was the external debt accumulation in East Asia far in excess of that in Latin America, but it also gave rise to a much larger amount of internal lending.[30] Resolution of the domestic debt burden constitutes a more important problem for most countries in the region than the servicing of external debt. In this sense, the external financial crisis created a domestic debt overhang in the private sector whose resolution requires considerable public intervention.

50. Countries suffering from increased defaults and NPLs have adopted different strategies for intervention in financial and corporate restructuring.[31] Moreover, restoring solvency has required financial engineering on both the asset and liability side of the bank's balance sheet. The losses created by revaluing the bad loans on the asset side had to be covered by injecting new capital. The instruments used in rescue operations have differed among countries, but in general, the recapitalization cost is estimated to have been large, reaching $50 billion in Indonesia, $33 billion in Thailand and $26 billion in the Republic of Korea.[32] The specialized agencies created to take over bad debt have attempted either to collect it from the borrower or to take possession of the underlying assets in order to realize their value through sales in the market. However, the absence of modern bankruptcy laws in many countries impeded the rapid transfer of ownership of the underlying collateral to creditors or the specialized agencies.[33] While the Republic of Korea and Malaysia have progressed further than the other countries in the resolution of bad domestic loans, the process is far from complete, suggesting that economic recovery may be more fragile than it appears.

51. In assessing the sustainability of the current recovery in East Asia, it is also important to note that so far global conditions have generally been favourable. In particular, the strength of United States growth has been an important factor in the expansion of exports from the region. However, external payments in the region are moving towards deficits, and maintaining imports may depend on renewed capital inflows. Moreover, a large amount of external debt has been rolled over with maturity falling due over two years. Therefore, rising foreign interest rates could pose a dilemma: attracting foreign capital would call for higher domestic interest rates which, in turn, could stifle growth and aggravate the difficulties of the banking system, adding to the associated pressures for increases in domestic public debt.

2. The Russian Federation

52. The Russian Government, for the purpose of maintaining international investor confidence, has been distinguishing between debts taken over from the ex-Soviet Union and those incurred subsequently. Total foreign currency-denominated Russian debt amounted to $148 billion at the end of 1999, about two thirds of which had been inherited from the former Soviet Union.[34] The remaining one third of foreign debt has been contracted since the founding of the Russian Federation in 1992. The ex-Soviet debt has been

rescheduled a number of times, while greater efforts were made to service the Russian Federation debt in full and on time until the financial crisis of August 1998 which was followed by a restructuring of the Government's short-term external obligations.

53. By world standards, the Russian foreign debt-to-GDP ratio appears relatively modest, and the debt-service burden manageable. Total debt was less than 60 per cent of GDP before the de facto devaluation of the ruble in August 1998. Although the ratio of debt to GDP subsequently underwent a sharp increase, at some 70 per cent of projected GDP in 2000,[35] it is still moderate compared with that of many debt-distressed developing countries. However, given the ineffective tax collection and massive capital outflows estimated at more than $20 billion annually,[36] the central Government has found it difficult to generate enough revenues and foreign currency to meet debt service. The debt-service burden was alleviated somewhat in the latter half of 1999 by the improvement of the economic situation which has been mainly the result of high oil prices and of the devaluation of the ruble but also of improved tax collection and reduced capital outflow. The improvement of the payments position of the Russian Federation has continued in 2000 with the strengthening of oil prices. This is manifested in a sizeable trade surplus and rising foreign exchange reserves. However, a number of structural and institutional shortcomings that led to the 1998 crisis are still present.

3. Latin America

54. The economic situation in Latin America deteriorated further in 1999 as the region continued to suffer from the impact of the international financial crises for a second consecutive year, and economic downturn deepened in many countries in the wake of the Russian crisis. Aggregate output of the region stagnated for the first time since 1990, after growth had already fallen to less than 2 per cent in 1998. As pressures on currencies mounted, there was a movement towards greater flexibility of exchange rates. In general, the access of Latin American countries to external financing has been less affected by recent events than that of East Asian countries. While the latter resorted to external surpluses to finance capital outflows, in Latin America there was a substantial deficit on current account, financed by capital inflows through various channels, including FDI, through which sharp cuts in domestic absorption and activity were thereby averted. However, for the countries worst affected such as Ecuador, Colombia and Venezuela, access to international markets remained restricted. Moreover Argentina's currency regime was subjected during 1999 to pressures linked, inter alia, to a severe recession and shifting external perceptions of creditworthiness.

55. The difference in performance between Brazil and Argentina provides a useful contrast for comparing alternative policy approaches. Until the beginning of 1999, policies in both countries were designed to defend exchange-rate regimes through high interest rates and fiscal restraint. High interest rates had caused structural imbalances as the interest cost of outstanding government debt more than offset primary budget surpluses, and the increased servicing costs of foreign debt offset improvements in export performance. As a result, both countries experienced a progressive loss of international investor confidence and severe pressures on their external payments positions.

56. In Brazil, since most foreign investors and local banks had been expecting the exchange-rate adjustment, capital outflows after the suspension of the peg were not substantial. Continued privatization sales to foreigners, as well as the return of optimism due to increased competitiveness and relaxation of policies, produced a recovery of FDI inflows and a swift return to the debt markets. The currency stabilized and interest rates were steadily reduced, providing a sharp reduction in the fiscal deficit and improvement in external debt servicing. The economy grew by about 1 per cent in 1999, a much higher rate than generally forecasted, and registered an annual growth rate of more than 3 per cent in the first quarter of 2000. In contrast to the growth of Brazil, Argentina's growth has been below expectations after the successful defence of its dollar peg, suggesting that, under capital flight, currency depreciations are less damaging than hikes in interest rates, particularly when the exposure to currency risk in the private sector is limited. In addition to experiencing a sharp reduction in exports to Brazil as a result of the currency adjustment, Argentina was adversely affected by the high real interest rates needed to support the exchange rate. Since the Government depends heavily on external financing to meet fiscal deficits, the increased burden of external debt has been accompanied by an accentuation of fiscal pressures.

57. The most severe financial difficulties in Latin America have been encountered by Ecuador which also suffers from both domestic and external debt problems. In October 1999, it became the first country to default on Brady bonds when the Government announced its decision to reschedule this debt, deferring payments up to seven years with a two-year grace period and reducing the interest rate. The dollarization plan announced in January 2000 and an open capital account effectively eliminate the distinction between domestic and external debt, aggravating the difficulties associated with loss of confidence. In combination with political uncertainties, the decision to default led to capital outflows of some $2.5 billion in 1999, about 20 per cent of GDP. These outflows had to be financed through deflation and drawing on international reserves. An initial drop in exports together with a sharp depreciation of the currency led to a further deterioration in the asset quality of an already weak financial system, generating a credit crunch and deepening the contraction of domestic demand. Since most external debt is owed by the public sector, the resulting difficulties are as much on the fiscal side as related to the balance of payments. In addition to the need to generate adequate foreign exchange to meet debt servicing, there is a domestic budgetary transfer problem of the kind experienced by many Latin American countries during the 1980s, since a budgetary surplus needs to be generated by net resource transfers from the private sector.

F. Issues in commercial debt work-outs

1. Financial crises, debt standstill and work-outs

58. Recent financial and international crises in a number of developing and transition economies have shown that there are considerable shortcomings in international arrangements for commercial debt work-outs. In particular, the absence of effective mechanisms for involving private creditors in the prevention and resolution of crises has not only meant that liquidity crises all too frequently develop into widespread defaults and bankruptcies, but also resulted in unequal and unfair distribution of the burden of crisis resolution between debtors and creditors as well as among the creditors themselves.

59. After the East Asian crisis, it has been increasingly suggested that an effective way of dealing with the rapid exit of creditors and speculative attacks on currencies would entail recourse to the principles of orderly debt work-outs along the lines of the national bankruptcy legislation of some major creditor countries, particularly chapter 11 of the United States Bankruptcy Code. The application of such principles could end the anomalous situation whereby debtors are judged de facto bankrupt without benefiting from the financial protection and relief that would accompany a de jure bankruptcy in major industrialized countries. These principles are especially relevant to international private debt crises resulting from liquidity problems because they are designed primarily to address financial restructuring rather than liquidation. They allow a temporary standstill on debt servicing based on recognition that an asset grab race by the creditors is detrimental to the debtor as well as to the creditors as a group. They provide the debtor with access to working capital needed to carry out its operations, while granting seniority status to new debt. Finally, they involve reorganization of assets and liabilities of the debtor, including extension of maturities, and, where needed, debt-equity conversion and debt write-off.

60. Naturally, the application of bankruptcy principles to cross-border debt involves a number of complex issues. The most contentious issue is the standstill mechanism. Clearly, to have the desired effect on currency stability, debt standstills should be accompanied by temporary exchange controls over capital-account transactions by residents and non-residents alike.

61. A possible drawback of such a standstill is that it may undermine confidence further, accelerate capital flight through informal channels and deepen contagion. However, the historical record does not necessarily support this argument. In this respect, the recent Malaysian experience with standstill holds some useful lessons. It was temporary and selective, and highly successful in bringing exchange-rate stability, reducing interest rates and preventing a deepening of recession. When the controls were lifted in September 1999, there was only a limited amount of capital outflow, and the country soon enjoyed an upgrading of its credit rating and normalized its relations with international capital markets.[37] Moreover, other evidence does not indicate that standstills have a long-term adverse impact on the access to international financial markets of the country imposing them.[38]

62. The international intervention in financial crises has indeed involved eventual recourse to standstills as

well as debt work-outs. For instance, during the Asian crisis, the Republic of Korea creditors eventually agreed to a standstill and rollover of short-term loans. However, for a number of reasons such arrangements did not attain the objectives sought by orderly debt work-out procedures. First, they invariably came after the collapse of the currencies and hike in interest rates, thereby failing to prevent widespread insolvencies. Thus "many of those who have analysed (the Republic of) Korea's 1997-1998 crisis contend that (the Republic of) Korea could have solved its liquidity problems sooner had a standstill mechanism been in place at the time it requested IMF assistance".[39] Second, official lending in such work-out exercises is typically designed primarily to bail out creditors rather than to provide balance-of-payments support to enable countries to finance current operations. Third, in the restructuring process, Governments are usually forced to assume private debt. Finally, creditors often tend to secure highly favourable terms on restructured debt.

2. Bond financing and reorganization

63. In view of the rapid increase in the share of bonds in external financing of developing countries, bond restructuring has gained added importance, particularly for sovereign borrowers. The notion that sovereign bonds as well as bank loans may need to be restructured has only very recently been accepted by the international community (though not necessarily by all segments of financial markets): most sovereign debtors that had issued bonds in the 1970s and 1980s remained current on such obligations during the debt crisis of the 1980s, while rescheduling and restructuring their commercial bank debt. As noted above, Ecuador, Pakistan and Ukraine are three recent examples of countries involved in bond reorganizations. In the case of the latter two countries, this involved only the extension of principal maturities rather than relief since reorganization was undertaken on a mark-to-market basis.

64. As for commercial bank debt, there are no established mechanisms for restructuring sovereign bonds. Moreover, there are serious difficulties in bond restructuring compared with rescheduling and restructuring of commercial bank debt, particularly syndicated credits.[40] First of all, there is a communication problem between the bond issuer and holders. In general, bond holders are anonymous and include a variety of investors, both individual and institutional. This problem is further aggravated by trading in secondary markets. This was less of a problem for Pakistan where bond holding was concentrated than for Ukraine where it was spread among numerous retail holders. Moreover, there are legal impediments to establishing communication mechanisms between issuers and holders as well as to dealing with non-participating holders, particularly under the laws of New York State or of England where most sovereign bonds have been issued. Current arrangements also encourage hold-outs since sovereign issuers are often required to include a waiver of sovereign immunity as part of the terms and conditions of the bonds. Thus, sovereign debtors do not enjoy the protection accorded to private debtors under insolvency procedures which tend to overrule hold-outs and eliminate free riders.

65. There are a number of proposals for dealing with these problems and providing a basis for orderly sovereign bond work-outs. These include adding provisions to international bond contracts for automatic triggers or changes in payment conditions; majority action and collective representation clauses to deal with hold-out creditors and secure binding agreements for all bond holders; and sharing clauses to deter litigation. At present, an important main concern of developing-country borrowers is that inclusion of such clauses may reduce their access to financial markets and raise the cost of bond financing by giving wrong signals to the market. Overcoming these problems may require an international mandate for introduction of such clauses into all international bond contracts, including those issued by major industrialized countries. While a number of industrialized countries have in fact already started using such clauses in their bond contracts, this practice is far from universal.

3. Comparability and burden-sharing between private and official creditors

66. An important issue that has emerged from official interventions in emerging market crises and debt negotiations is the question of "comparability" and "burden-sharing" between the private and official creditors. Official bail-out operations in recent emerging market crises have increasingly been criticized as risking public money to bail out private creditors, and suggestions have been made that public assistance should not be made available unless debtors obtain some relief from private creditors. More

recently, Paris Club creditors advised Pakistan to seek "comparable treatment" from its private bond holders by rescheduling its eurobond obligations. A similar request was subsequently put forward by the Paris Club to Nigeria. In this case, official creditors appear to have demanded that commercial counterparts such as bond holders be included in a final settlement and accept the terms of a restructuring prior to the conclusion of a Paris Club agreement.

67. An equally important question is whether burden-sharing should be symmetrical when official negotiations are preceded by private creditor agreements. Some private creditors have been challenging the "fairness" of the current burden-sharing implicit in commercial and official debt work-outs, pointing out that official creditors as compared with private creditors do not show matching generosity in debt restructuring. This issue of "reverse comparability" is likely to arise in future official debt negotiations. As noted above, the Russian Federation has obtained a large amount of debt reduction from its London Club creditors, and the expectations of commercial creditors and the Russian Government appear to be that the next round of Paris Club negotiations should match the debt reduction accorded by private creditors. Again, private creditors of Ecuador have agreed to a deal before its official creditors, and its Paris Club negotiations are likely to involve the question of reverse comparability.

68. The emphasis on burden-sharing and comparable treatment between private and official creditors constitutes a major advance over the debt strategies adopted during the 1980s as well as the more recent emerging-market crises when official intervention in debt crises was designed primarily to keep sovereign debtors current on debt servicing to private creditors, and when the seniority accorded to multilateral debt went unchallenged. However, it should be added that the emphasis on burden-sharing among creditors should not overshadow the more important question of equitable treatment of debtors and creditors.

III. International policy conclusions

69. The analysis above shows that there are serious shortcomings in the international approach to the debt problems of developing countries and economies in transition. Overcoming these difficulties would call for action on three fronts: the HIPC Initiative, the official debt of non-HIPC countries, and commercial debt.

70. The HIPC Initiative has received considerable support in the international community as a comprehensive and coordinated approach based on a recognition of the need to reach a sustainable debt position for the countries concerned in the context of growth and development. However, so far it has progressed only in incremental steps, and even with the acceleration up to the end of 2000 in the number of countries benefiting from agreed debt reduction, the initiative is unlikely to reach the objectives set. The problems associated with its design and implementation suggest that even the enhanced HIPC Initiative does not provide an adequate response to HIPCs' debt problems. A bolder approach will have to be taken to remove the debt overhang of the world's poorest nations.

71. This new approach might take the form of an objective and comprehensive assessment by an independent panel of experts not unduly influenced by creditor interests, while the existing processes are under way. Such an assessment, which should not be restricted to HIPC countries but should also encompass other debt-distressed low-income and middle-income countries, should naturally include debt sustainability, eligibility for debt reduction, the amount of debt reduction needed, conditionality, and modalities regarding the provision of necessary funds, including those for the multilateral financial institutions affected. There should also be a commitment on the part of creditors to implementing fully and swiftly any recommendation of this panel regarding the writing-off of unpayable debt. Moreover, in future, HIPCs and other countries covered by the panel's recommendations should benefit from new aid resources in grant form or on highly concessional terms, in order to avoid the renewed build-up of an unsustainable debt burden.

72. There should also be an immediate suspension of the debt-service payments of all HIPCs, with no consequent additional interest obligations being incurred until the panel has made its recommendations and agreement has been reached on reduction of their debts. This suspension should also be extended to non-HIPC countries declared eligible for debt relief by the panel during the period until agreements on the debt reduction in their case are reached.

73. It is notable that a recent independent commission of experts from different schools of thought appointed by the United States Congress, the Meltzer Commission, has made proposals that go well beyond the scope of the HIPC Initiative.[41] The Commission agreed unanimously on the desirability of writing off all multilateral claims against HIPCs that had implemented an effective development strategy. It also recommended that bilateral creditors should similarly write off these countries debts, and that grants rather than loan-based funding should be used in the majority of programmes. These specific recommendations should not be ignored in the controversy over the Meltzer Commission's other proposals.

74. The point is not, of course, to see full and swift debt relief as a panacea for the deep-seated policy challenges facing these countries. It would, however, be one less problem for their policy makers to deal with. Many of these countries are unable to meet their external debt-servicing obligations, and for them debt relief will simply formally acknowledge a situation that already exists and stop the accumulation of arrears that are unlikely ever to be paid.

75. Reform of the international strategy regarding the official debt of poor countries should also address the problems of debt-distressed low-income countries that are not currently eligible for the special treatment accorded to the HIPCs. Non-HIPC least developed countries and other debt-distressed low-income countries should not be excluded from consideration under the HIPC Initiative. Indeed, an independent assessment of debt sustainability and eligibility is likely to bring many such countries into the group needing rapid and sizeable relief on bilateral and multilateral debt. Some of the severely indebted middle-income countries may also require such arrangements, and as a first step it may be desirable to extend bilateral ODA cancellation and concessional rescheduling of other official debts to such countries.

76. It is also important to recognize that countries that are seriously affected by war and natural disasters and that face serious problems of reconstruction and recovery require debt relief as well as urgent assistance regardless of their longer-term prospects and debt profiles. Various measures could be envisaged, ranging from automatic standstill and rollover for countries brought under the United Nations emergency rules to outright cancellation of debts.

77. For commercial debt, establishing orderly and equitable work-out procedures with explicit responsibilities of creditors and debtors and well-defined roles for public and private sectors remains the most important step that should be taken. Serious consideration should be given to a number of different proposals that have recently been advanced in this context: firstly, the introduction of emergency standstills which would be mandated by IMF members, as proposed by the Canadian Government;[42] secondly, the introduction of arrangements setting the terms for pre-qualification for unilateral standstill decisions; and thirdly, empowering an independent panel to sanction such decisions ex post facto in a way analogous to the procedures of World Trade Organization safeguard provisions that allow countries to take emergency actions. Again, consideration should be given to the establishment of an international mandate for the introduction of covenants in international bond contracts enabling debtors to alter payment conditions when faced with severe financial difficulties.

78. Given the volatility of private capital flows and increased frequency of liquidity problems in emerging markets, provision of international liquidity, as well as temporary standstills, should constitute an essential component of an effective international financial architecture. While the recently adopted practice of lending into arrears by multilateral financial institutions is a welcome development, it is important to ensure that such lending would not simply bail out private creditors, but actually help the debtors to finance their current-account transactions. Furthermore, conditions attached to such lending should not interfere with the proper jurisdiction of sovereign Governments, and should be confined to macroeconomic and financial variables.

Notes

[1] The debtor countries included in this analysis are the low- and middle-income countries (developing countries and countries in transition) covered by the World Bank Debtor Reporting System (DRS). The main data sources are the World Bank, *Global Development Finance 2000* (Washington, D.C., 2000), the joint Bank for International Settlements (BIS)-International Monetary Fund (IMF)-Organisation for Economic Cooperation and Development (OECD)-World Bank statistics on external debt and IMF, *World Economic Outlook, May 2000* (Washington, D.C., 2000).

[2] IMF, *World Economic Outlook, May 2000*.

[3] The most recent amendment to the list is the addition of Gambia in 2000.

[4] For a discussion of the Cologne debt initiative, see also A/54/370, paras. 43-57.

[5] Under the new framework, the present value of debt is to be reduced to a maximum of 150 per cent of exports (as compared with a range of 200-250 per cent under the original framework) and 250 per cent of government revenue (previously 280 per cent). The amount of debt relief to be delivered is determined at the decision point, based on actual data.

[6] Of these, Bolivia, Uganda and Mozambique had already reached the completion point under the original framework.

[7] Cf. World Bank and IMF, "The enhanced initiative for heavily indebted poor countries: review of implementation", 7 September 2000.

[8] Statement of Group of Seven (G-7) finance ministers and central bank governors, Washington, D.C., 16 April 2000.

[9] G-7 statement, Okinawa, 21 July 2000.

[10] Group of Eight (G-8) communiqué Okinawa 2000 (A/55/257-S/2000/76, annex), Okinawa, 23 July 2000.

[11] Cf. also "Poverty reduction and economic development", report from G-7 finance ministers to the heads of State and Government, Okinawa, 21 July 2000.

[12] As of end-July 2000, the World Bank HIPC Trust Fund had received close to $2.6 billion in contributions and pledges from over 20 countries.

[13] See "Heavily Indebted Poor Countries Initiative and Poverty Reduction Strategy Papers: progress reports", memorandum from James D. Wolfensohn and Horst Köhler to members of the International Monetary and Financial Committee and members of the Development Committee, 7 September 2000.

[14] See further, for example, Tony Killick, "HIPC II and conditionality: business as before or a new beginning", paper commissioned by the Commonwealth Secretariat for the policy workshop on debt, HIPC and poverty reduction, London, 17 and 18 July 2000.

[15] See UNCTAD, *Capital Flows and Growth in Africa* (Geneva, UNCTAD 2000) (UNCTAD/GDS/MDPB/7).

[16] See Killick, loc. cit.

[17] Other debtor countries rescheduling with official creditors encounter similar problems.

[18] See World Bank, *Global Development Finance 2000*. "Debt-distressed" in the following refers to both severely and moderately indebted countries. Afghanistan and the Comoros are classified as severely indebted, while Bangladesh, Cambodia, Equatorial Guinea, Haiti and Samoa are classified as moderately indebted.

[19] Debt conversion involves the exchange of debt for another liability or the cancellation of debt in return for an expenditure by the debtor. This includes, for example, the swapping of government debt for equity in privatized enterprises, or for the financing of environmental, developmental and educational schemes.

[20] See, for example, "Finding solutions to the debt problems of developing countries", report of the Executive Committee on Economic and Social Affairs of the United Nations, December 1999.

[21] Argentina, Brazil, Chile, Mexico and Venezuela in Latin America; Indonesia, Malaysia, the Philippines, the Republic of Korea and Thailand in Asia.

[22] In debt buy-backs, the debtor country takes advantage of the discount in the secondary market to buy back the debt, and the operations are financed either out of foreign exchange reserves or through the issue of new bonds. Exchanges of Brady bonds involve their replacement by new issues of the international bonds before their maturity.

[23] See, further, World Bank, *Global Development Finance 2000*, appendix 2.

[24] See "Supervisory lessons to be drawn from the Asian crisis", *Basel Committee on Banking Supervision Working Paper, No. 2* (Basel, BIS, June 1999), tables 2 and 5; and BIS, "BIS-consolidated international banking statistics for end-December 1999", *Press Releases*.

[25] For an analysis of the crisis and recovery in East Asia see, UNCTAD, *Trade and Development Report, 2000* (United Nations publication, Sales No. E.00.II.D.19), chap. IV.

[26] See World Bank, *East Asia: Recovery and Beyond* (Washington, D.C., May 2000), table 5.1.

[27] See UNCTAD, *Trade and Development Report, 1999* (United Nations publication, Sales No. E.99.II.D.1), chart 5.4.

[28] See World Bank, *East Asia: Recovery and Beyond* ...

[29] Ibid., table 5.1 and figure 5.2.

[30] See UNCTAD, *Trade and Development Report, 1998* (United Nations publication, Sales No. E.98.II.D.6), Part one, chap. III, sect. D, p. 71, and table 31.

[31] For different strategies, see UNCTAD, *Trade and Development Report, 2000* ..., box 4.2.

[32] World Bank, *East Asia: Recovery and Beyond* ...

[33] For a discussion of how these agencies operated, see UNCTAD, *Trade and Development Report, 2000* ..., box 4.2.

[34] IMF, *World Economic Outlook, May 2000*.

[35] Ibid.

[36] IMF, "Capital flight from Russia", Policy Discussion Paper, June 2000.

[37] For the rationale, nature and effects of these controls see UNCTAD, *Trade and Development Report, 2000* ..., box 4.1.

[38] As the Deputy Governor of the Bank of England, David Clementi, put it in a recent speech: " ... would standstills risk cutting off capital flows to the emerging markets — if you like, killing the goose that lays the golden egg? History offers some clues here. For example, there appears to be no evidence from 1930s experience of defaulting countries having fared worse than non-defaulting countries in terms of subsequent output growth. And looking across a broader sweep of history, some empirical evidence has failed to find any discernibly negative long-term effect of a country's prior debt-servicing record on the terms or volume of its borrowing." See *BIS Review*, 70/2000.

[39] Ministry of Finance and Economy, Republic of Korea, Group of 20 (G-20) report, *Korea's Crisis Resolution and its Policy Implications*, p. 13, December 1999.

[40] On the problems involved in bond restructuring, also see further "Sovereign debtors and their bondholders", United Nations Institute for Training and Research (UNITAR) training programmes on foreign economic relations, Document No. 1; and A. de la Cruz, "The new international financial architecture: Has 1999 (Ecuador and others) changed anything?", paper presented to the Debt Management and Financial Analysis System (DMFAS) Conference on Debt Management, April 2000.

[41] *Report of the International Financial Institution Advisory Commission* (Meltzer Commission), March 2000, executive summary and chap. 2.

[42] Canada, Department of Finance, "Canada's six-point plan to restore confidence and sustain growth", September 1998.